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Canadian FIs — Start Collecting Non-Resident Account Details

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Canadian financial institutions will soon have to collect information on financial accounts held by tax residents of jurisdictions outside of Canada and the United States and provide these details to the CRA. This requirement is part of an international initiative under which Canada has agreed to provide this information to other countries' tax authorities in exchange for information about financial accounts held by Canadians in those jurisdictions. Although this reciprocal exchange of information begins in 2018, affected financial institutions must have procedures in place to identify this information by July 1, 2017.

Canada's proposed common reporting standard rules will require financial institutions in Canada to identify accounts held by residents of jurisdictions outside of Canada and the United States (including persons with dual or multiple residency) and report specific information relating to these accounts directly to the CRA each year. Under these rules, financial institutions must report information such as account balances, interest, dividends received and proceeds from the sale of financial assets. These rules apply to accounts held by individuals and certain entities.

Canada's proposed common reporting standard rules, introduced on April 15, 2016, include concepts that are largely drawn from the U.S.-based *Foreign Account Tax Compliance Act* (FATCA), which has a similar focus on financial accounts and the financial institutions that maintain them. As a result, Canadian financial institutions may be able to leverage certain aspects of the systems they currently have in place to meet the Canadian rules that require them to comply with FATCA (the Canadian FATCA rules in Part XVIII of the *Income Tax Act*).

Background
The CRA signed the international Multilateral Competent Authority Agreement in June

2015 to activate the automatic exchange of financial information between tax jurisdictions beginning in 2018, based on a standard developed by the OECD. Canada is one of more than 100 countries around the world that have committed to implement the common reporting standard, and many have begun enacting legislation in their jurisdictions. These measures are a significant step towards a globally coordinated approach to disclosure of income earned by individuals and organizations and are drawn heavily from the intergovernmental approach to implementing the U.S.-based FATCA.

To make the exchange of information possible, financial institutions, as defined under domestic and international law, must report information according to the common reporting standard on accounts held by foreign-resident individuals and entities such as certain corporations, trusts and foundations.

Canada's government released draft legislation on April 15, 2016 to implement this reporting. The draft legislation introduces new provisions to the *Income Tax Act* contained in sections 270 to 280 of new Part XIX, "Common Reporting Standard" that come into force on July 1, 2017.

Finance further clarified some aspects of the rules in additional draft legislation released July 29, 2016 concerning taxpayer identification number (TIN) and penalties in dispute. Finance is also proposing to make a couple of "house-keeping" amendments to the Canadian Foreign Account Tax Compliance Act (FATCA) rules to better align them with the due diligence rules under the common reporting standard.

Who has to report?

Under the proposed common reporting standard rules, a "reporting financial institution" is required to identify accounts held by tax residents of jurisdictions other than Canada and the United States and report certain account information to the CRA. However, a corporation, trust, partnership, joint venture or other Canadian resident entity that is not a Canadian financial institution (a "non-financial entity" or "NFE") is still generally required to self-certify its entity classification under the proposed rules to any reporting financial institution with which it holds a financial account.

Financial institutions

A financial institution is specifically defined as a "custodial institution," a "depository institution," an "investment entity" or a "specified insurance company" in proposed section 270 of the new rules. These are, generally speaking, regulated financial intermediaries that include banks, credit unions, and securities dealers. Note that these categories are not mutually exclusive, and an entity can be more than one type of financial institution. A financial institution must be resident in Canada (or, in the case of a foreign financial institution, be a branch that is resident in Canada) and also be a "listed financial institution" (as currently defined in the Canadian FATCA rules), to meet the definition of “Canadian financial institution”.

A Canadian financial institution is a “reporting financial institution” unless it is specifically carved out as a “non-reporting financial institution”. Non-reporting financial institutions are defined in the proposed rules to include governmental entities, international organizations and certain retirement funds and pension funds, among others. These entities are exempt from the obligation to carry out due diligence and report on the financial accounts they maintain.

KPMG observations
Supplemental executive retirement plans (SERPs) and other retirement compensation arrangements may not be exempt from the common reporting standard rules even though they may be exempt under the Canadian FATCA rules.

Non-financial entities

A “non-financial entity” (NFE) is essentially any Canadian resident entity that is not a Canadian financial institution (or, if the entity is a non-resident of Canada, it is not a “financial institution”). An NFE is generally required to self-certify to any reporting financial institution with which it holds a financial account whether it is a “passive NFE” or an “active NFE”. A passive NFE is required to meet additional information requirements, such as reporting the individuals who control it (i.e., “controlling persons”).

KPMG observations
The common reporting standard rules differ from the Canadian FATCA rules in a number of important ways. For example, the common reporting standard rules do not provide an exemption for financial institutions with a local client base. The Canadian FATCA rules provide an exemption for financial institutions with 98% of their financial accounts (by value) held by Canadian residents. Small credit unions that benefit from this FATCA exemption may not be exempt from the common reporting standard rules.

Due diligence and reporting requirements

Pre-existing accounts

A reporting financial institution is required to carry out specific due diligence procedures on pre-existing individual and entity accounts that were opened before July 1, 2017. These institutions must review their financial accounts for indicators of account holders with a foreign residency and implement processes that identify any change in circumstances.

To be a “reportable account”, a financial account must be held by an individual or entity that is resident in any jurisdiction other than Canada or the United States (i.e., a “reportable person”). In addition, a reportable account may be a financial account held by a “passive NFE” if one or more “controlling persons” of the passive NFE is a reportable person. Note that financial institutions, corporations whose stock is publicly traded, and governmental entities, among others are excluded from the definition of “reportable person”.

Recent draft legislation released July 29, 2016 states that a reportable person must provide his or her taxpayer identification number (TIN) at the request of any person required to make an information return that requires the TIN. Failing to provide a TIN can result in a $500 penalty. This legislation also notes that that reportable persons will not be entitled to any repayment of a penalty in dispute by filing an objection.

Financial institutions are only required to report entity accounts that have an account balance or value balance greater than US$250,000 on June 30, 2017 (or where the balance or value exceeds US$250,000 on the last day of any subsequent calendar year).

A reporting financial institution must complete enhanced due diligence procedures before 2019 for pre-existing individual accounts with an aggregate balance or value that exceeds US$1 million on June 30, 2017. For pre-existing individual accounts that do not exceed US$1 million and entity accounts that have account balances greater than US $250,000, due diligence procedures must be completed before 2020.

New accounts

For new accounts that are opened after June 30, 2017, reporting financial institutions are required to collect appropriate self-certifications and documentary evidence to identify reportable accounts. Financial institutions must validate these self-certifications.

KPMG observations

The new due diligence requirements for reporting financial institutions go beyond what is currently required of Canadian financial institutions to meet their existing “anti-money laundering” and “know your client” (AML/KYC) obligations. Accordingly, compliance with the common reporting standard, like FATCA before it, will be an ongoing project for most affected financial institutions.

In addition, some aspects of the common reporting standard rules are significantly broader than those under the Canadian FATCA rules. For example:

- The concept of “reportable persons” in the common reporting standard rules is broader than the concept of “specified U.S. persons” under the Canadian FATCA rules
- The common reporting standard rules require a factually-sensitive assessment of tax “residence” to determine residency, as opposed to the bright-line threshold of US citizenship applicable to most accounts reportable under FATCA

- Unlike Canadian FATCA, the common reporting standard does not provide a *de minimis* exemption for pre-existing individual accounts below US$50,000. Accounts in the form of, or held by, a tax-free savings account (TFSA) are subject to due diligence and potential reporting under the common reporting standard rules. RRSPs and RRIFs continue to be exempted

- A portfolio manager whose sole role or activity is to provide investment management advice or portfolio management services to clients will likely have no due diligence or reporting obligations under the common reporting standard rules even though portfolio managers will typically qualify as reporting financial institutions.

Annual returns

A reporting financial institution must file a prescribed information return with the CRA by May 1 of each year, starting May 1, 2018. This return must provide information relating to reportable accounts that it maintained at any time during the preceding calendar year and after June 30, 2017. Specifically, financial institutions will be required to report information such as account balances, interest, dividends received and proceeds from the sale of financial assets.

KPMG observations
There are no registration or withholding tax regimes under the common reporting standards as there is with the Canadian FATCA rules. Instead, reporting financial institutions can expect to be subject to penalties under the Act for failure to report (although these provisions have yet to be proposed). In addition, the rules include a $500 penalty for reportable persons who fail to provide their Taxpayer Identification Number (TIN) upon request to a reporting financial institution.

We can help

Canadian financial institutions should keep abreast of the progress of the common reporting standard as the rules make their way into law and to prepare to put due diligence procedures in place by July 1, 2017.

Your KPMG adviser can help you evaluate your organization’s readiness to comply with reporting obligations in countries adopting the OECD’s common reporting standard, including Canada. We can help you meet reporting obligations as required by domestic and international tax law.

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